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June 12, 2013

Robert deV. Frierson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

**Re: Supervision and Regulation Assessments for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of \$50 Billion or More and Nonbank Financial Companies Supervised by the Federal Reserve (Docket No. 1457 and RIN 7100-AD-95)**

Dear Mr. Frierson:

On behalf of Nationwide Mutual Insurance Company and its affiliated companies ("Nationwide"), we appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve ("Board") on its proposed rule (the "Proposed Rule") to implement Section 318 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act"), which directs the Board to collect assessments, fees, or other charges equal to the total expenses the Board estimates are necessary or appropriate to carry out the supervisory and regulatory responsibilities of the Board for bank holding companies ("BHCs") and savings and loan holding companies ("SLHCs") with total consolidated assets of \$50 billion or more and nonbank financial companies designated for Board supervision by the Financial Stability Oversight Council ("FSOC") (collectively, "covered institutions").

Nationwide is a diversified financial services organization offering a wide range of insurance, annuities, and investment products and services. Nationwide Mutual Insurance Company ("Nationwide Mutual") is the lead entity and ultimate controlling person of all entities in the Nationwide group of companies. Nationwide Mutual is an operating insurance company which, along with its property and casualty insurance subsidiaries, primarily underwrites personal automobile, homeowners and commercial insurance products. Nationwide Financial Services, Inc. ("Nationwide Financial"), a subsidiary of Nationwide Mutual, develops and sells a diverse range of products, including individual annuities, private and public sector retirement plans and other investment products sold to institutions, life insurance and advisory services. In addition, Nationwide Financial provides mutual funds through Nationwide Funds Group and banking products and services through Nationwide Bank, a federal savings bank and member FDIC.

By virtue of its ultimate ownership of Nationwide Bank, Nationwide Mutual is registered as a SLHC pursuant to Section 10 of the *Home Owners' Loan Act of 1933* ("HOLA"), and is the



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top-tier SLHC of Nationwide Bank. As of December 31, 2012, Nationwide Mutual had total consolidated assets of around \$168 billion and as such, would be subject to the Proposed Rule.

In connection with our more detailed comments below, Nationwide respectfully requests that the Board refine the Proposed Rule as follows:

- Nationwide recommends that the Board adopt a tiered approach whereby the assessment basis is apportioned among assessed companies based on the number of supervisory activities to which the assessed company is subject.
- The Board should amend the definition of "Total Assessable Assets" to exclude separate accounts assets of insurers as these assets are offset by a corresponding liability to the policyholder based on fair market value of these assets. Therefore, they should not result in an insurance company commanding additional supervisory attention.

### **Specific Comments**

#### **1. The Board should adopt a tiered approach whereby companies are assessed based on the number of Board supervisory activities to which they are subject.**

In the Preamble to the Proposed Rule, the Board provides the following rationale for proposing an assessment formula based purely on size:

Larger companies are often more complex companies, with associated risks that play a larger role in determining the supervisory resources needed for that company. The largest companies, because of their increased complexity, risk and geographic footprints, usually receive more supervisory attention.<sup>1</sup>

We agree with the Board that the largest companies usually receive more supervisory attention because of their increased complexity, risk and geographic sweep. However, Nationwide submits that size *by itself* is not necessarily indicative of an institution's complexity and risk. Moreover, larger institutions do not always command more supervisory attention. While there may be instances where larger companies require more supervisory attention, this is unlikely to be case for SLHCs with relatively small depository institutions, and that are not subject to the Dodd-Frank Act's section 165 enhanced prudential standards. It is even less likely with respect to operating insurance companies that are already subject to State prudential supervision and assessments.

The foregoing premise is clearly reflected in the Dodd-Frank Act wherein Congress directed the Federal Reserve to establish enhanced prudential standards for a limited subset of companies based on a number of factors *in addition to size*: (1) BHCs with over \$50 billion in

<sup>1</sup> 78 Fed. Reg. 23162, 23165 (April 18, 2013).



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assets; and (2) nonbank financial companies designated by FSOC ("nonbank SIFIs").<sup>2</sup> First, BHCs are included in this subset of companies due to the risk that their banking activities pose to the greater financial system, *in addition to their size*. Second, Congress directed the FSOC to consider a litany of factors when designating nonbank financial companies for Board supervision, which include: (i) leverage; (ii) off-balance sheet exposures; (iii) extent and nature of transactions and relationships with other significant nonbank financial companies and significant bank holding companies; (iv) the importance of the company as a source of credit for households; (v) the importance of the company as a source of credit to low-income, minority, or underserved communities; (vi) the extent of the company's asset management activities; (vii) nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company; (viii) the degree to which a company is regulated by 1 or more primary financial regulatory agencies amount and types of liabilities of the company, including the degree of reliance on short-term funding; (ix) the amount and nature of the financial assets of the company; (x) the amount and types of liabilities of the company; and (ix) any other risk related factors.<sup>3</sup>

Congress has recognized that BHCs with \$50 billion or more in total consolidated assets and nonbank SIFIs present a greater degree of complexity and risk that is not based purely on their size, but is due to the risk that their activities pose to the financial stability of the U.S., as represented by the enumerated factors listed above. Accordingly, Congress has mandated that these companies warrant a greater level of supervisory attention. Therefore, as a matter of equity, their assessment should reflect this enhanced level of Board supervision.

The Board will likely expend significant time and resources drafting rules and carrying out its supervisory responsibilities related to the section 165 enhanced prudential standards, which will include: (i) enhanced risk-based capital and leverage limits; (ii) enhanced liquidity risk management requirements; (iii) resolution plan preparation and filing requirements; (iv) credit exposure report preparation and filing requirements; (v) single counterparty credit limits; (vi) annual supervisory stress tests conducted by the Board; and (vii) mid-cycle company-run stress tests, among others.<sup>4</sup> If the assessment is apportioned among companies based on size alone, then it would result in a number of companies that are not subject to the foregoing supervisory requirements being assessed for the Federal Reserve's cost of carrying them out. Specifically, SLHCs with over \$50 billion in total consolidated assets that are not non-bank SIFIs would not be subject to the vast majority of the section 165 enhanced prudential standards. Thus, these companies should not be assessed for the Board's expenses in carrying out its supervisory responsibilities under those standards. Otherwise, these SLHCs will be subsidizing an enhanced level of supervision to which they are not subject.

<sup>2</sup> 12 U.S.C. § 5365(a)(1).

<sup>3</sup> 12 U.S.C. § 5323(a)(2).

<sup>4</sup> While SLHCs with over \$10 billion in total consolidated assets would be subject to Annual Company-Run Stress Tests under Section 165(i)(2)(A), they are not subject to Supervisory Stress Tests and Mid-Cycle Company-Run Stress Tests.



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Consider, for example, a SLHC with \$160 billion in total assessable assets under the Proposed Rule for 2012, with a savings association subsidiary that has roughly \$5 billion in assets, and that is not a nonbank SIFI. Using estimates provided by the Board, such an SLHC would be subject to a \$3.6 million assessment for 2012. On the other hand, consider a BHC with total assessable assets of \$80 billion, and whose depository institution makes up the majority of its asset base. As a BHC with over \$50 billion in total consolidated assets, such an institution would be subject to the section 165 enhanced supervision and prudential standards. For this institution, the Board will expend significant time and resources conducting stress tests, publishing results of stress tests, assessing resolution plans, reviewing credit exposure reports, reviewing company-run stress tests, ensuring compliance with liquidity risk management requirements, among others supervisory activities. However, the assessment for this institution would be around \$1.8 million dollars (or about half that of the SLHC mentioned above which is not subject to the section 165 enhanced prudential standards). Such a result does not fairly or accurately allocate the Board's total expenses for supervising the 70 assessed companies identified in the Proposed Rule. Moreover, such an approach does not reflect principles of sound prudential supervision that aligns supervisory cost to a firm's risk profile and exposure.

We respectfully urge the Board to revise the Proposed Rule to prevent companies from being assessed for expenses associated with supervisory activities to which they are not subject. In the Preamble to the Proposed Rule, the Board asks in Question 7, "*What alternatives should the Board consider for differentiating assessments among assessed companies (for example, a tiered fee structure), and why?*"<sup>5</sup> Nationwide recommends that the Board adopt a tiered approach whereby the assessment basis is apportioned among assessed companies based on the number of supervisory activities to which the assessed company is subject, with each supervisory activity weighted based on the expense (or percentage of time) the Board devotes to that supervisory activity. Below is an illustrative example of how such an approach could work.

	Activity #1	Activity #2	Activity #3	Activity #4
<b>% of Time Allocated to Activity</b>	40%	30%	20%	10%
<b>Activity Assessment Basis (assuming \$440 million aggregate assessment basis)</b>	\$176 million	\$132 million	\$88 million	\$44 million
<b># of companies subject to activity</b>	70	60	35	35
<b>Total Assessable Assets of Assessed Companies subject to the Activity</b>	\$20 trillion	\$18 trillion	\$15 trillion	\$15 trillion

As shown in the above table, the Board would divide the \$440 million assessment basis among the various supervisory activities it conducts, based on the percentage of time associated with each activity. The assessment bases for each supervisory activity would then be apportioned among the number of assessed companies subject to that supervisory activity based on their asset size and by using the respective assessment rate associated with that activity. The assessment rate would generally be calculated as follows:

<sup>5</sup> 78 Fed. Reg. 23162, 23165.



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$$\text{Activity Assessment Rate} = \frac{\text{Activity Assessment Basis}}{\text{Total Assessable Assets of Assessed Companies subject to the Activity}}$$

Thus, under the above average approach, if an assessed company were only subject to Activities #1 and #2 above, it would be apportioned a percentage of the "Activity Assessment Basis" for Activities #1 and #2, which would be determined by applying the respective Activity Assessment Rates to its Total Assessable Assets.<sup>6</sup>

By refining the Proposed Rule in this manner, companies would only be assessed for the expenses associated with supervisory activities to which they are subject, which we believe is a more equitable approach. We believe that this approach is consistent with a risk based prudential framework that aligns risk exposure to the degree of supervisory activity. Consistent with sound prudential supervisory principles, firms with greater exposure and requiring more supervisory activity would pay more. We believe that this approach is even more compelling when the firm is an operating insurance company already subject to State prudential supervision and assessments.

## **2. The Board should exclude separate account assets from the definition of "total assessable assets"**

Nationwide is supportive of an assessment approach whereby the assessment is based on the complexity, risk and the corresponding level of supervisory attention the institution commands. However, to the extent size is used in any assessment formula as a proxy for the complexity and/or risk of a covered institution, a life insurer's separate account assets should be excluded from the calculation of asset size as these separate account assets are offset by a corresponding liability to the policyholder, and as the fair value of the separate account assets fluctuates, so does the liability to the policyholder.

For grandfathered, unitary SLHCs like Nationwide Mutual, Section 246.4(e)(4) of the Proposed Rule provides as follows:

[T]otal assessable assets will be determined by the average of the [SLHC's] total consolidated assets as reported for the assessment period on the regulatory reports on the [SLHC's] Form FR Y-9C, column B of the Quarterly Savings and Loan Holding Company Report (FR 2320), or other reports as determined by the Board as applicable to the [SLHC].

<sup>6</sup> As discussed in Section 2 below, we respectfully request that the Board remove insurance company separate account assets from the calculation of "Total Assessable Assets."



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By using the total consolidated assets figure reported on the FR Y-9C (or column B of the FR 2320) to determine total assessable assets for purposes of the Proposed Rule, an insurance company's separate account assets are included in determining its total assessable assets. Nationwide respectfully urges the Board to exclude separate account assets from the definition of total assessable assets. Including separate account assets in the calculation of total assessable assets would have the effect of inappropriately inflating an insurance company's assessment.

State law allows for the creation of separate accounts to hold a segregated pool of assets, which is maintained separately from an insurance company's general account. Insurance companies use separate accounts to support certain products, such as variable annuities and variable life insurance. The contract holder's premiums for these products are invested through the separate account in a portfolio of securities in accordance with a set of investment objectives and policies dictated by the contract holder. Generally, the contract holder bears the investment risk of the assets in the separate account. On the other hand, the premiums from certain products, such as fixed annuities and traditional life insurance, are invested in the insurance company's general account. With respect to these general account products, the insurance company guarantees the return of the contract holder's principal and a guaranteed rate of return. Thus, the insurance company bears the investment risk with respect to general account products.

Although separate account assets are included in the calculation of total consolidated assets for GAAP accounting purposes, this treatment reflects the required legal ownership of the separate account assets by the insurance company, but does not reflect the fact that the contract holder bears all market and credit risk associated with the separate account assets.

Under applicable law, the insurer owns the underlying assets in the separate account and records them on its balance sheet along with a "linked" liability to the separate account customer equal to the fair value of those assets. The insurance company's payment obligation to a customer with a separate account product is based on the performance of the assets held in the dedicated separate account, and the customer can withdraw the fair value of the assets in the separate account. Moreover, insurers must invest the contract holder's funds within the separate account as directed by the contract holder or in accordance with specific investment objectives or policies. All investment performance, net of fees, must be passed through to the individual contract holder. In addition, separate account assets are not subject to the claims of general creditors of the insurance company, therefore, the contract holder is insulated from insurer default risk to the extent of the separate account assets. An insurance company's balance sheet is essentially "grossed up" for separate account assets, and corresponding liabilities (offset or net exposure to the general account would be \$0). In cases where an insurance company guarantees the performance of assets in a separate account, the insurance company must reserve for this liability, and the asset backing this reserve will be included in the insurance company's general account assets.

Separate account assets of an insurance company are analogous to collective trust funds, including collective investment funds and common trust funds, operated by trust



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companies and trust departments of financial institutions pursuant to their fiduciary powers. In these situations, the bank as trustee or custodian of the fund maintains a separate accounting of the assets that are not included in the general assets of the bank. Trust assets would not be counted toward a bank's total assets for purposes of the assessment under the Proposed Rule. Likewise, separate account assets of an insurance company should be excluded from the calculation of total assessable assets for purposes of the assessment under the Proposed Rule.

Notably, and consistent with the above reasons, when assessing the systemic risk posed by nonbank financial firms under its interpretive guidance, the FSOC excluded separate account assets from the calculation of "total consolidated assets" for purposes of the leverage ratio and short-term debt ratio Stage 1 designation criteria.<sup>7</sup> Likewise, the Board should exclude separate account assets from the definition of "Total Assessable Assets" because the assets are offset by corresponding liability to the policyholder, and as the fair value of the separate account assets fluctuates, so does the liability to the policyholder.

### **Conclusion**

Thus, in order to ensure that companies subject to the Proposed Rule truly are assessed based on their complexity, risk and the corresponding level of supervisory attention required for the institution, Nationwide respectfully requests that the Board make the above revisions to the Proposed Rule.

As always, we appreciate the dialogue and look forward to further opportunities to comment.

Very truly yours,

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Executive Vice President and Chief Financial Officer

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<sup>7</sup> 12 CFR part 1310, Appendix.